Proskauer

newsletter

Wealth Management Update

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in this issue

A monthly report for wealth management professionals.

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As part of our ongoing efforts to keep wealth management professionals informed of recent developments related to our practice area, we have summarized below some items we think would be of interest. Please let us know if you have any questions.

December Interest Rates Down for GRATs, Sales to Defective Grantor Trusts, Intra-Family Loans and Split Interest Charitable Trusts

The December applicable federal rate ("AFR") for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 1.8%, a new record low rate. The rate for use with a sale to a defective grantor trust, self-cancelling installment note ("SCIN") or intra-family loan with a note of a 9-year duration (the mid-term rate, compounded annually) is also down, to 1.53%. Remember that lower rates work best with GRATs, CLATs, sales to defective grantor trusts, private annuities, SCINs and intra-family loans. The combination of a low AFR and a decline in the financial and real estate markets presents a potentially rewarding opportunity to fund GRATs in December with depressed assets you expect to perform better in the coming years. However, legislation currently is pending in Congress that would significantly curtail short-term and zeroed-out GRATs. Therefore, GRATs should be funded immediately in order to be grandfathered from the effective date of any new legislation that may be enacted.

Clients also should continue to consider "refinancing" existing intra-family loans. The AFRs (based on annual compounding) used in connection with intra-family loans are .32% for loans with a term of 3 years or less, 1.53% for loans with a term of 9 years or less and 3.53% for loans with a term of longer than 9 years.

Thus, for example, if a nine-year loan is made to a child and the child can invest the funds and obtain a return in excess of 1.53%, the child will be able to keep any returns over 1.53%. These same rates are used in connection with sales to defective grantor trusts.

Value of New York Real Property Not Entitled to Discount Based on Will's Creation of Life Estate in Property

In *New York Advisory Opinion No. TSB-A-10(5)M* (10/21/2010), the New York Department of Taxation and Finance held that the estate of a decedent filed a petition to determine whether, in calculating the value of New York real property included in its gross estate, the estate should factor in a discount for a life estate in the property created by the decedent's Will. The Department of Taxation and Finance ruled that no discount was allowed as it is well established (by federal cases such as *Ahmanson Foundation v. United States* and *Curry v. United States*) that the value of property for estate tax purposes is determined as in the hands of the estate and without regard to the disposition of property by Will.

Homestead Exemption Allowed for Separated (But Not Divorced) Taxpayer

In *Wells v. Haldeos*, Fla. Dist. Ct. App., 2nd Dist., Dkt. No. 2D09-4250 (10/22/2010), an appeal by the property appraiser of Pasco County, Florida of a final judgment in favor of the taxpayer, the Florida District Court of Appeals for the 2nd Circuit held that a separated (but not divorced) taxpayer was eligible to receive a homestead exemption for his property in Florida despite the fact that his wife receives a residency-based property tax exemption on a separate property in New York. The property appraiser had denied the Florida homestead exemption on the grounds that, by statute, a "family unit" cannot receive more than one homestead exemption and that a legally married couple is a "family unit." The trial court had held that it would defy logic for two people who have no contact with each other and are not financially dependent on one another to be called a family unit. Thus, the trial court ruled that they may obtain separate homestead exemptions. The appeals court upheld the decision of the trial court and stated, further, that the Florida Department of Revenue has enacted a rule instructing property appraisers that married persons may be considered separate "family units" in certain circumstances (such as separation). This approach also has been upheld by the Attorney General of Florida.

Disclaimer Not Qualified Where Disclaimed Property Passed to Disclaimant by Intestacy

In *Estate of Tatum, Jr. v. U.S.*, 106 AFTR 2d 2010-6556 (S.D. Miss. 10/6/2010), the Southern District of Mississippi held that a disclaimer was not qualified where the disclaimed property passed to the disclaimant by intestacy. At issue was property disclaimed by a decedent when his father died in 1987, leaving his residuary estate 60% to the decedent and 20% to each of the decedent's nephews. At such time, the disclaimer was approved by the Mississippi probate court and, as a result, the decedent's share of the residue, consisting mostly of stock, was distributed to his children, as if he had predeceased his father. On the decedent's death, IRS assessed a gift tax deficiency and penalty against decedent's estate, claiming that decedent was liable for gift tax on the transfer of stock to his children. IRS claimed that the disclaimer was not qualified because the property passed back to the son by intestacy, which failed the requirement of Code Section 2518 that the disclaimed property pass to a person other than the disclaimant. Apparently, under Mississippi law at the time of the death of the decedent's father, if a condition was not provided for in the will, the state's intestacy statute would control. As the father's Will provided for an alternate disposition of the residuary estate if one of his beneficiaries predeceased him, but not where one of them disclaimed, the disclaimed property simply passed back to the decedent by intestacy. Thus, the decedent's estate was liable for gift tax on the transfer of the disclaimed property to his sons.

No Charitable Contribution Deduction for Donation of House to Local Fire Department Where Value of Demolition Services Exceeded Value of Property

In *Theodore R. Rolfs, et ux. V. Comm'r*, 135 T.C. No. 24 (11/4/2010), the Tax Court denied a charitable contribution deduction for donation of a house to the local fire department where the value of the demolition services that the taxpayer would receive exceeded the value of the donated property. The taxpayers had bought the 3-acre property on which the house sat several years before they donated the house and decided to tear down the lake house and build a new house in its place. After donating the house to the local fire department for use in firefighter and police training exercises, and eventual demolition, the taxpayers claimed a $76,000 income tax charitable deduction, based on an appraisal that they received from a local realtor. The IRS's experts, however, stated that the value of the home was de minimis when taken apart from the land. In analyzing the quid pro quo argument set forth by the IRS, the Tax Court was persuaded, in part, by the fact that the taxpayers had lacked donative intent – they had determined to burn the house down prior to deciding to donate it, so that they expected to receive a benefit. Thus, the court ruled that no deduction was allowed, as the value of the services that the taxpayers received was greater than the value of what they donated to charity.

Trust Cannot Claim Charitable Deduction for Fair Market Value of Appreciated Property Donated to Charity, Despite Fact that Property Was Purchased with Trust Gross Income

In Chief Counsel Advice 201042023 (10/22/2010), IRS has held that a trust cannot claim an income tax charitable deduction for the fair market value of appreciated property donated to charity, despite the fact that the property was purchased with the trust's gross income from prior years and was traceable to that income. Under Code Section 642(c)(1), an income tax charitable deduction is allowed to a trust only for contributions made out of gross income. Contributions made from income accumulated in prior years also are deductible, but only if no deduction was allowed to the trust in any prior year for the amount presently contributed. In the present case, the trust agreement provided that the trustee could distribute to charity such amounts of the trust's gross income as the trustee determined. The trust purchased three properties with prior years' gross income and donated one property each to three charities. The trust based it charitable contribution deduction on the fair market value of the properties at the time they were donated, rather than on the trust's basis in each property. IRS concluded that the trust's charitable deduction was limited to the trust's adjusted bases in the properties, and stated that to conclude otherwise would give the trust a double tax advantage: (1) avoidance of tax on the potential gain and (2) the ability to deduct not only the basis, but also the gain, from gross income.

Insurance Policy in Pension Plan Will Be Treated as Ordinary Life Insurance Contract and Death Benefits Considered Incidental If Less than 50% of the Participant's Total Contributions to the Plan Are Applied To Pay Premiums on the Life Insurance Contract

In Private Letter Ruling 201043048 (10/29/2010), IRS ruled that an insurance policy in a pension plan will be treated as an ordinary life insurance contract and the death benefits will be considered incidental, as less than 50% of the participants' total contributions to the plan were applied to pay premiums on the life insurance contract. Regulation 1.401-1(b)(1) permits a qualified retirement plan (as defined in Code Section 401(a)(1)) to provide for the payment of "incidental" death benefits through insurance. Revenue Ruling 54-51 provides that an investment by a profit-sharing plan in an ordinary life insurance contract for an insurable participant in such plan will be considered incidental if (1) the aggregate premiums for life insurance for such participant constitutes less than one-half of the total contributions made by him at any particular time and (2) the plan requires the trustee to convert the entire value of the life insurance contract at or before retirement to provide periodic income so that no portion of the money may be used to continue life insurance beyond retirement. The policy at issue in the PLR was a level premium level face amount whole life insurance policy. IRS determined that the terms of the policy were such that the guaranteed cash values under the policy generally exceeded 50% of the accumulated premiums, and thus less than 50% of the premiums would be used for pure insurance protection. Accordingly, for purposes of applying the rules set forth in Revenue Ruling 54-51 (above), IRS treated the policy as an "ordinary" life insurance contract and determined that the death benefit paid thereunder would be considered "incidental."

The Personal Planning Department at Proskauer is one of the largest private wealth management teams in the country and works with high net-worth individuals and families to design customized estate and wealth transfer plans, and with individuals and institutions to assist in the administration of trusts and estates.

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